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IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LESTER TURNER, SUTCLIFFE BAXTER and EDGAR AMES, as TRUSTEES IN BANKRUPTCY OF WESTERN STEEL CORPORATION,
Appellants,

vs.

METROPOLITAN TRUST COMPANY of the CITY OF NEW YORK,
Appellee.

No. 2257.

Appeal from the District Court of the United States for the Western District of Washington, Northern Division, Sitting in Bankruptcy.

Brief of Appellee

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STATEMENT OF THE CASE.

This is an appeal from an order of the District Court, sitting in bankruptcy, allowing the claim filed by Metropolitan Trust Company, appellee, against the bankrupt estate of Western Steel Corporation. The Trust Company's claim, allowed by the District Court, is based on $2,000,000 of first

mortgage bonds of the bankrupt and on a promissory note of the bankrupt for $600,000, upon which certain credits have been endorsed.

The $2,000,000 of bonds were originally held by the Trust Company as collateral to the $600,000 note, and the only question to be determined on this appeal is whether, by foreclosure in accordance with the terms of the pledge, the Trust Company terminated the pledge relationship and acquired a clear title to the bonds.

The facts regarding the note and bonds, and the Trust Company's ownership of them, are not in dispute, and are as follows:

Facts Regarding Bonds.

The Trust Company loaned the bankrupt $600,000 on the bankrupt's four months' note for $600,000, set forth in the Trust Company's proof of claim, taking as collateral the $2,000,000 of first mortgage bonds now in controversy.

The pledge agreement (Transcript, p. 50) authorized the pledgee, on default in payment of the note, to sell the collateral at public or private sale, without either advertisement or notice, which, by the terms of the pledge, were expressly waived.

At any public sale of the collateral, the Trust Company was, by the terms of the pledge agreement, entitled to become a purchaser. The note fell due August 1, 1911, and on that day *the Trust Company notified the maker*, Western Steel Corporation, *that if the note was not paid on or before August 28, the securities would be sold at public auction on August 30, and that the Trust Company would look to the maker for any deficiency remaining after the sale.* (Transcript, p. 53.) This letter was duly received, and acknowledged by letter of Western Steel Corporation, by its president, dated August 11, 1911, in which no objection was made to the sale of the collateral at the time fixed, in case the note remained unpaid. (Transcript, p. 54.) The note was not paid and the collateral bonds were sold at public auction on the date set in the Trust Company's letter of August 1st. (Transcript, p. 20.) The auction sale at which the bonds were sold was a regular weekly sale of stocks, bonds and financial securities generally, admittedly largely attended by buyers of such securities (Transcript, p. 21). It was advertised in the best media for reaching buyers of such securities (Transcript, p. 20). Notices of the sale were mailed to the principal bond buyers, banking and financial corporations, firms and individuals

in the financial district of New York City (Transcript, p. 20).

At the sale the bonds were purchased in behalf of Metropolitan Trust Company as the highest and best bidder, for the sum of $25,000 (which amount was credited upon the $600,000 note (Transcript, p. 20).

The trustees, while admitting that the advertising was in the proper media, do not admit that it was sufficiently long-continued for the sale of unlisted securities, but the only evidence on the point is to be found in the testimony of Brayton Ives (Transcript, p. 44), and of Andrew J. McCormack (Transcript, p. 55). From their affidavits it appears that the notice given was such as is usual in the sale of such securities, and that the regular weekly sales, at one of which these bonds were sold, are sales of exactly the class of securities to which these bonds belong, *i. e.*, unlisted stocks and bonds which are not dealt in on the New York Stock Exchange, nor sold on the curb.

Appellants' statement of facts relative to value and appraisal of the property of Western Steel Corporation is erroneous, but as this involves a general discussion of the trustees' third ground of objection to the order of the District Court, we will

take it up under our argument on that point (III) *infra.*

More detailed facts regarding the sale of the bonds in New York will also be stated hereafter, under III.

ARGUMENT.

The bankruptcy trustees attack the decree of the court below on the following grounds:

I. *That pledged collateral consisting of additional obligations of the pledgor, such as the pledgor's corporate bonds, though secured by mortgage, cannot, even by the most scrupulous observance of the contract of pledge, be foreclosed so as to transfer to a purchaser, whether the pledgee or another taking with knowledge of the facts, any title to the pledged securities.*

II. *That, on the evidence presented, both the Referee and the District Court were wrong in their respective findings that our sale of the bonds in New York was made honestly, fairly, and without fraudulent intent, and that, (a) from the evidence of the notice given, and (b) from alleged inadequacy of the price at which the bonds were bid in, this court should reverse this finding in which the Referee and the District Judge both concur, and*

should find that the sale of the bonds in New York was conceived and carried out for the fraudulent purpose of preventing the public from bidding upon the pledged bonds, and in order, by a secret and colorable sale, to fraudulently increase the amount of the Trust Company's claim.

III. *That the public notice was unreasonably short and the sale therefore invalid, because not a public sale.*

IV. *That the sale was bad because of inadequacy of price.*

Without preliminary discussion of the general features of the case, we will separately consider the above four grounds on which the appellant trustees ask this court to reverse the decree of the District Court.

I.

Concerning appellants' claim that pledged collateral consisting of additional obligations of the pledgor, such as the pledgor's corporate bonds, though secured by mortgage, cannot, even by the most scrupulous observance of the contract of pledge, be foreclosed so as to transfer to a purchaser, whether the pledgee or another with knowledge of the facts, any title to the pledged securities.

To our minds the mere clear statement of this contention seems enough to condemn it as inconsistent with the intention of the parties and the needs of business. Sustaining the trustees would amount to cancelling the contract between the parties, without returning the money which the lender has advanced upon the faith of it.

Contracts of pledge are usually, as in the case at bar, entered into in consideration of a cash loan by the pledgee to the pledgor, and the loan is made in reliance on the collateral and on the pledgor's contract that the collateral may be sold and the pledge relationship terminated at the time and in the manner set forth in the contract of pledge. Admittedly contracts permitting the sale of pledged securities at public or private sale, are in general valid and enforcible, and if a corporation purchases bonds of another corporation, and pledges them to a bank as collateral for a loan of less than their value, and upon default, the bank, in accordance with the contract of pledge, sells the collateral, such sale is valid and terminates the relation of pledgor and pledgee, and the purchaser, whether the pledgee himself or a stranger, acquires an absolute and indefeasible title to the pledged property, free of any right of the pledgor to redeem it. But our opponents claim

that if, instead of pledging bonds of another company, the pledgor prefers to pledge its own mortgage bonds, though of the same value and pledged for a loan of the same amount, such contract of pledge is for some reason invalid and unenforcible, and the pledgee cannot rid himself of the pledged collaterals.

In order to demonstrate the unsoundness of this suggestion we must consider what rights would be given such a pledgee under the theory advanced in behalf of the bankruptcy trustees.

The trustees do not claim that the pledge itself is invalid, but admit that the pledgee should eventually have the benefit of the security. They say, however, that he cannot exercise the power given him in the contract of pledge, to sell the collateral and to become himself a purchaser. How then is the pledgee to enforce his security? The trustees' contention appears to be that he must hold the bonds until the liquidation of the pledgor company's assets, and that, in the meantime, he is deprived of his contract right to sell the bonds at public or private sale and to become, if he so desires, himself a bidder at such sale.

It is manifestly the intention of both parties that in case of foreclosure of the pledge the bonds de-

posited as collateral shall be sold as existing securities, and not that the mortgage securing the same shall be foreclosed, or the properties covered by such mortgage bid in and reduced to possession.

The latter course would usually be less favorable to the pledgor-mortgagor company, and would often be disastrous to it.

It would also, in many cases, *be impossible,* since, if the bonds did not bear annual interest, or if the interest were kept paid up, *the mortgage might not be in default, though the principal debt, as security for which the bonds were pledged, might be long overdue.*

The sole remedy and means of foreclosure open to the pledgee would, in such case, be by sale of the collateral bonds; and if that right were to be denied, it would amount to a total denial of his right to realize on his security.

Appellants may say that under their doctrine the creditor could at any time sell his interest as pledgee in the pledged property, such being, in one of the cases cited (*Peacock vs. Phillips*, 93 N. E. 415), held to be the effect of a sale of the collateral in accordance with the contract of pledge.

But who would purchase a mere pledgee's right in bonds pledged for an overdue debt, if the bonds could not be sold so as to convey a clear title to them? The mortgaged property might depreciate or the value of the bonds fall before a default should occur under the mortgage, and cumbrous foreclosure proceedings would absorb time and money before anything could be realized by such procedure.

Under such a rule, on default of payment, a pledgee obliged to realize within a reasonable time upon his collateral, *would be forced to sell his loan at a heavy sacrifice* to some speculator willing to hold it until the pledged obligations should themselves mature, and until they could be foreclosed.

The intent of the parties that the pledgee should sell the only thing pledged, i. e., *the bonds*, and quickly liquidate the security, would be utterly defeated and violated.

Appellants Ask Court to Make New Contract for Them.

It is idle to ask this court to make a new contract for the parties. If the pledgee had a right to sell the bonds at all, it had under the contract a right to become the purchaser, and on becoming the purchaser it acquired as good a title as any other

purchaser. That is the meaning of the provision that "the pledgee may become a purchaser,"—not that the pledgee may purchase what it owns already, *a pledgee's interest, but that it may purchase what is offered for sale, the full legal title to the thing pledged.*

If the pledgee bids at a public sale and the bonds are knocked down to him as the highest bidder, he must take the same title as any other purchaser, for if he took as pledgee still, his relation to the bonds would, as we have seen, remain unchanged, his right to become a purchaser would prove useless, and he might as well have had no sale at all. The provision permitting him to become a bidder is for the benefit of the pledgee, to permit him, if he so desires, to acquire the bonds at a price as high or higher than anyone else will pay at a fairly conducted public sale. He therefore acquires them absolutely, with the right to sell them again when opportunity offers, *with no more liability to account for the proceeds of such subsequent sale than he would have right to claim of the pledgor an accounting for his loss, in case he bid in the bonds at fifty, and was forced to resell them at twenty-five.*

To whittle down this title to a mere right to enforce the bonds for the amount of the original debt is equivalent to disregarding the pledge of the bonds and substituting for them as security a mortgage which it will require at least two years to foreclose in a distant foreign jurisdiction. Plainly, the New York trust company would not have accepted such a mortgage as security for its four months' loan. The consideration for that loan was Moore's guarantee of immediate payment upon maturity, and a deposit of collaterals which could be sold and realized upon at once in case of default.

A decision to the effect that a pledgee of corporate bonds to secure a corporate debt cannot foreclose the same by sale of the bonds in the same manner as a pledge of any other bonds or securities would simply inhibit the borrowing of money upon the collateral usually most convenient for a borrowing corporation to give, namely, its own securities.

Appellants' Authorities on This Point.

The appellant trustees, whose exhaustive search of the authorities is evidenced by their whole brief, have been able to find and cite only two cases which they claim in any degree support their contention on this point.

One of these cases (*Peacock vs. Phillips*, 93 N. E. 415), though of very doubtful soundness, expressly limits the doctrine which it enunciates to personal promissory notes, (which it seems to presume are not intended to be thrown upon the market, but rather to be held and collected when due) and expressly distinguishes and exempts from its doctrine corporate bonds, saying:

"Appellant relies upon a decision relating to collateral of that kind (corporate bonds) * * * Bonds of that kind are issued for the purpose of raising funds for the corporation and are intended to be thrown upon the market and to pass from hand to hand. The mortgage or trust deed secures the holders of the bonds, and they can be enforced by such holders for the full face value, regardless of equities. To permit equitable defenses to be interposed would practically destroy such methods of raising money, and the corporation is properly estopped to deny its liability" (citing authorities).

The *Peacock* case is largely based on an Illinois statute under which notes and mortgages are held non-assignable, and holds that a note and mortgage, taken as collateral security for a smaller note of the same maker and bid in by a purchaser having knowledge of the facts, cannot be enforced for a greater amount than that due on the original note.

Peacock vs. Phillips being thus eliminated, the only remaining case cited as supporting appellants'

doctrine is *Knickerbocker Trust Co. vs. Penacook Mfg. Co.,* 100 Fed. 814. This is a decision by Aldrich, District Judge, in the Circuit Court for the District of New Hampshire. It is very brief, cites no authorities, and contains no discussion of the principles involved, and, standing as an isolated and unconsidered ruling, at variance with universal practice and the authority of the higher courts on a transaction which is constantly occurring, seems entitled to but little weight.

Authorities Fully Sustain Title of Pledgee.

As against the solitary decision of a district judge in New Hampshire (a state famous for its peculiar local doctrines, at variance with the weight of authority over the country), we have the well established and uniform business practice permitting the pledging and sale of bonds issued by the corporation which pledges them, the same as any other securities, two decisions of the Circuit Court of Appeals for the Sixth Circuit, several decisions of Circuit Courts, including one in the Ninth Circuit, and decisions of the highest courts of a number of the states:

Farmers' Loan & Trust Co. vs. Toledo & S. H. R. Co., C. C. A. 6th Circuit; 54 Fed. 759.

Gilchrist Transportation Co. vs. Phoenix Ins. Co., C. C. A., 6th Circuit; 170 Fed. 279.

Atlantic Trust Co. vs. Woodbridge Canal & Irrigation Co. (Circuit Court, Northern District of California), 86 Fed. 975.

Fidelity Insurance Company vs. Roanoke Iron Co., 81 Fed. 439.
Chouteau v. Allen. 70 Mo. 290.
Wheelwright vs. St. Louis N. O. & O. C. T. Co., 56 Fed. 164.

In re Woods, 52 Maryland, 520.
Jerome v. McCarter, 94 U.S. 734. 24 L.Ed. 136.
In *Farmers' Loan & Trust Co. vs. Toledo & S. H. R. Co.*, C. C. A., 6th Circuit, 54 Fed. 759, the court, composed of Jackson and Taft, Circuit Judges, and Hammond, District Judge, holds, in a suit for the foreclosure of a railway bond mortgage, that bonds pledged by the railroad company as collateral security for a debt and put up at public sale and bid in by the pledgee on foreclosure of pledge, should be allowed in their full amount, though bid in for a very small sum, saying:

"The securities having been regularly issued and hypothecated as collateral for a debt the company was authorized to contract, and thereafter lawfully sold under the terms of the pledge upon proper notice, * * * we think the court below was in error in not allowing the decree of foreclosure to go for the full amount of 210 bonds and unpaid coupons thereto attached."

The court in this case puts its decision both on the ground that the transaction was valid on its face, and that it was not open to attack by other creditors of the company. If, as appellants contend, such a pledge is bad in law and cannot be foreclosed by any procedure so as to have the effect of increasing the claim of the original pledgee and permitting him to prove the bonds as an independent indebtedness as against the issuing company and its other creditors, then the title of the bank to these bonds would have been held still to be that of pledgee only, and they would have been allowed in the amount of $20,000.00 instead of $210,000.00. *The situation was precisely the same as in the case of Knickerbocker Trust Co. vs. Penacook Mfg. Co.,* appellants' sole reliance, in which other creditors intervened and there is no showing that the foreclosure was ever contested by the pledgor company.

In *Gilchrist Transportation Co. vs. Phoenix Ins. Co.,* C. C. A., 6th Circuit, 170 Fed. 279, the court considers an objection that a pledge of mortgage bonds to secure a lesser debt of the company issuing the bonds does not constitute a present incumbrance under the mortgage, the appellant contending that the indebtedness could not be thus in-

creased or multiplied. The court, speaking by Severens, C. J., says (p. 283):

"The last ground taken is that 'the pledge by plaintiff in error of its bonds, in order to secure other obligations than those evidenced by the bonds which the mortgage was to secure, did not create a present incumbrance under the bonds and mortgage and did not forfeit the policy.' This contention is equally hopeless. It is doubtless true that a mere additional promise by a debtor to pay his own debt is a vain thing. But not so if the additional promise to pay is itself secured by some new security. In that case the new promise may be used as a link to connect the new security to the old debt. However, there is no need of circuity. *It is now well settled that a corporation may lawfully issue to a creditor its bonds secured by mortgage in pledge for* the payment of another of its obligations."

In *Atlantic Trust Co. vs. Woodbridge Canal & Irr. Co.* (Circuit Court, N. D. Cal.), 86 Fed. 975, the court, by Morrow, C. J., in a foreclosure action, holds that bonds pledged to secure a lesser obligation of the company issuing the bonds and subsequently foreclosed by sale at public auction, in accordance with the terms of the pledge, and bought in by the pledgee, should be allowed in their full amount, the court saying:

"These bonds had been pledged to the intervenors (Buell & Co.) as security for certain materials furnished to the defendant corporation. I held that the intervenors were entitled to be paid the amount pledged on the bonds. *It is now claimed,*

however, that with respect to the bonds held by Buell & Co., one of the intervenors, the full face value of the bonds should be allowed to them, as they were sold at public auction, in accordance with the terms of the pledge, and were bought in by Buell & Co. Without entering into a discussion of the question, it may be said that Buell & Co., having bought in the bonds held by them as pledge security, are entitled, under the decision of the Supreme Court in *Wade vs. Railroad Co.*, 149 U. S. 327, 13 Sup. Ct. 892, to the full face value of the bonds. See also, *Farmers' Loan & Trust Co. vs. Toledo & S. H. R. Co.*, 4 C. C. A. 561, 54 Fed. 759, 774; *Wheelwright vs. Transportation Co.*, 56 Fed. 164. Therefore, so far as the bonds held by Buell & Co., and bought in by them, are concerned, they are entitled to be paid their par value of $1,000 each, provided the residue of the proceeds of sale, after the payment of preferential claims, is sufficient to pay in full all of the bonds now presented."

Fidelity Insurance Co. vs. Roanoke Iron Co., 81 Fed. 439, concerns $12,000 par value of bonds of the Iron Company, pledged to secure its note for $5,000. (See p. 449.)

Wheelwright vs. St. Louis N. O. & O. C. T. Co., 56 Fed. 164, concerns bonds of defendant company, pledged to secure the company's note.

Were it necessary a distinction might well be made between pledges of corporate mortgage bonds and pledges of mere additional promissory notes of the pledgor, the former being issued and put upon the market for the very purpose of circulating

from hand to hand and furnishing a ready means of liquidation and sale of claims against the issuing company, and the latter being perhaps primarily intended to be held by the payee until maturity. But there is little necessity for making this distinction, since the question as to pledges of additional collateral notes of the pledgee was early set at rest by the leading case of *In re Woods,* (1879) 52 Md. 520. This was a case arising in the winding up of the estate of an insolvent debtor. As stated by counsel for the trustee at the outset of the report (p. 521): "The principal question in this case is * * * whether a debtor can give his own notes, not merely as the *evidence* of his indebtedness, *but as collateral security* for it; or whether a simple contract creditor, holding notes of his debtor of the face value of $100,000, for instance, but upon which he has advanced to his debtor only $50,000, stands in any better position than if the notes only represented the $50,000 on their face."

The pledged notes were made by and payable to the order of the pledgors and indorsed by them to the pledgee under a pledge agreement permitting the pledgee to sell the securities at any time, at public or private sale, without notice, and to become a purchaser at such sale.

The court says:

"The contingency of a sale is expressly provided for, and its effects must have been within the contemplation of the parties when the contracts were made. Are they then valid and lawful contracts? In answer to this question I must say I am unable to perceive upon what ground they can be successfully assailed. * * * But it is said the giving of these notes was a mere increase or duplication of the debt due by the firm to the Garretts, and they cannot be used or considered as collateral security therefor. * * * It is true the effect of carrying out these contracts by a sale of the notes was to increase the *general indebtedness of* the firm, but it did not increase the debt then due the Garretts for which the notes were pledged as security. But this increase of general indebtedness is exactly what the contracts contemplated, and what the parties intended in case a sale was made, so that the question comes back at last to the validity of the contracts in this respect. Now, if instead of giving these notes, in the form in which they were drawn, to the Garretts as collateral security, the firm had placed them in the hands of a broker, for sale, and he had sold them to the same parties, and for the same price the Garretts obtained for them, and the firm had received the proceeds and applied them to this debt, exactly the same result would have followed. There would have been the same increase of the general indebtedness of the firm and the same diminution of the Garrett debt, which was effected by the sale under the contract, and in the case supposed it will hardly be contended that the purchasers would not have had a valid claim against the firm for the full amount of the notes. Such notes are constantly sold on the streets in all the large commercial cities of the country. * * * With this right of sale, the notes became, in the

hands of the Garretts, a valuable and reliable security for the debts due to them under the letters of credit, and I am unable to discover any ground on which the firm or their other creditors can impeach the transactions. The authorities cited in support of opposite conclusions, while differing in other respects, appear to me to be clearly distinguishable from the present case in that there is here an express power of sale, which the parties intended, if carried into effect, should result in the consequences which have followed, and which has been actually executed."

II.

Concerning appellants' argument that, on the evidence presented, both the Referee and the District Court were wrong in their respective findings that our sale of the bonds in New York was made honestly, fairly, and without fraudulent intent, and that (a) from the evidence of the notice given, and (b) from the alleged inadequacy of the price at which the bonds were bid in, this court should reverse this finding in which the Referee and District Judge both concur, and should find that the sale of the bonds in New York was conceived and carried out for the fraudulent purpose of preventing the public from bidding upon the pledged bonds, and in order, by a secret and colorable sale, to increase the Western Steel Corporations' indebtedness.

No Issue of Fraud or Bad Faith Has Been Raised.

The trustees' objections to the claims of Metropolitan Trust Company, though lengthy and carefully drawn by able counsel after several months' investigation of the affairs of the bankrupt company, make no charge of fraud or bad faith, and nowhere impugn the good faith of the Trust Company in foreclosing its lien upon the pledged collateral. (Transcript, pp. 1 to 7.) The trustees alleged their legal conclusion that the notice of the sale was insufficient and that the price at which the bonds were bid in was inadequate, but did not allege bad faith on the part of the Trust Company. Upon the objections coming on for hearing before the Referee, then, there was no issue of fraud before the court, and the good faith of the transaction was not involved in the objections to the Trust Company's claim. The matter being submitted upon all the evidence now before this court, and on all files and records, there was no evidence of fraud, collusion, or bad faith, unless that inference is to be drawn from the simple fact that the Trust Company sold the bonds in accordance with the universal usage, upon the customary notice, and in conformity with the terms of the contract of pledge.

Foreclosure of the pledge by a public sale in accordance with contract being shown, the burden of proof is on the trustees in bankruptcy to allege and prove fraud.

> *Hiscock vs. Varick Bank*, 206 U. S. 28; 51 Law Ed. 945.

It is usually held, too, that a finding of fact in which the Referee and District Judge substantially concur will be accepted as final by this court, and the evidence will not be reviewed.

> *Smith vs. National Suffolk Bank*, 127 Fed. 286.
>
> *Collier on Bankruptcy* (9th Ed.) p. 547.
>
> *Naylon vs. Christiansen Harness Mfg. Co.* (C. C. A., 6th Circuit), 158 Fed. 290.
>
> *In re Sweeney*, 168 Fed. 612.

In *2 Loveland on Bankruptcy*, 4th Ed., Sec. 847, the rule is stated as follows:

"If the findings of fact of a referee and a judge are the same, the facts will not usually be inquired into by the appellate court."

We shall discuss under our next heading (III) the sufficiency and reasonableness of the notice given. It is plain that no fraudulent intent can be implied from a notice which all the evidence in the case shows to be that which is usual and customary.

The Western Steel Corporation and its properties were *known*, but not thought well of in New York (Transcript, p. 23), and that low opinion subsequent events have justified.

The personal notice from the Trust Company to Western Steel Corporation (Transcript p. 18) is also in itself sufficient to negative a fraudulent intent on the part of the Trust Company in calling the sale.

Even had no advertisement or public notice been given, the sale would have been perfectly valid, since it occurred at a regular weekly auction of unlisted financial securities (Transcript, p. 47), largely attended by buyers. (Transcript, p. 21.) The character of these weekly sales of Adrian H. Muller & Son is illustrated in the cases of *Farmers' National Bank of Annapolis vs. Venner* (Supreme Judicial Court of Massachusetts), 78 N. E. 540, and *White, Rec'r, vs. City of Rahway*, 16 Fed. 833. In the *Venner* case the court comments on the fact that it was conceded that these were proper auctioneers, and that their sales room was a proper place for the day auction.

In the *Rahway case* (1882), Muller & Son are referred to as "the well known stock auctioneers," and a sale at their regular Wednesday auction of

stocks and bonds is confirmed. It is shown, too, and not contradicted, that these are the sales rooms designated by the Appellate Division of the Supreme Court of New York, and that the auctioneers who sold the pledged bonds are the only auctioneers doing any considerable business there. (Transcript, pp. 57-58.)

How can counsel ask the court to find fraudulent intent from the mere putting up of bonds at what appears to be the principal weekly auction sales of such securities, held in the metropolis and financial center of this hemisphere, and upon notice to the pledgor and to the principal bond buyers and moneyed men of that financial district?

Bidding in of Bonds at $25,000 Not a Fraud on Pledgor.

To the claim of the trustees that the bidding in of the bonds for $25,000 was a fraud on Western Steel Corporation, or was evidence of fraudulent intent or bad faith, we answer:

1. That $25,000 was a fair price, and that there is no evidence that at the time they were sold the bonds were worth more.

2. That even if they were worth more, there is no evidence that the pledgee knew they were worth more.

3. That under the contract of pledge the test of public sale in the New York market was to be conclusive and final, and no duty was imposed upon the pledgee to incur the expense and delay incident to such an inquiry into the details of the properties as would be necessary in order to determine the probable intrinsic value of the bonds.

1. Record contains no evidence that bonds at time of sale had a cash value in excess of $25,000.

If it were a fact it would have been very easy for the trustees to have shown that people in New York, Seattle, British Columbia, or elsewhere stood ready to pay more than $25,000 for the bonds, or to show by the testimony of New York bankers and brokers that by reasonable efforts a better price could have been obtained for them; but there is no such testimony. None could be had. The only testimony which it is even argued justifies a finding of a higher value for the bonds is evidence of the appraisal in bankruptcy of the entire assets of the company, nearly half a year later. There is no evidence that the value of the properties (admittedly of a highly speculative character) had not greatly

increased since the previous summer, and, in fact, it appears from the appraisal that the principal item covered by the mortgage was appraised at *33⅓% more than cost.* (Transcript, pp. 23, 34.)

Bearing in mind that the appraisal is merely an expression of opinion by men having no previous acquaintance with the properties, who find them enormously overcapitalized by the defunct company, and make their estimates largely on an assumption of the correctness of the bankrupt's cruises and engineering reports (Transcript, pp. 29, 43), let us examine it in detail.

Taking the first item of the appraisal, *power plant and equipment* (Transcript, p. 30), and comparing it with the first item of the supplemental or corrected appraisal (Transcript, p. 37), it is seen that the greater part of the valuation is in buildings, machinery and equipment, and *that the buildings are not valued separately from the machinery and equipment, which latter are not covered by the mortgage securing the bonds.* (Transcript, p. 22.)

The court may perhaps take judicial notice that the principal part of the value of a steel rolling mill plant lies, not in the mere wood skeleton buildings, but in machinery, which under Washington decisions is personalty, not covered by the mortgage.

Zimmermann vs. Bosse (1910), 60 Washington 556.

Sherrick vs. Cotter, 28 Washington 25.

Neufelder vs. Third Street Ry., 23 Washington 470.

The only items in the Irondale valuation which can be determined to be covered by the mortgage are as follows:

Twenty-acre plant site valued at.....................	$ 10,000
Twenty acres filled tide lands valued at (Transcript, p. 37)	5,000
With a contingent item for lots in which the bankrupt's title was uncertain, amounting to (Transcript, p. 38)..........	2,500
And other scattered realty appraised at......	3,500
Next we find 150 acres in Snohomish County valued at	1,000
And property in Skagit County at................	1,500
We find a very high valuation placed on mineral claims in British Columbia, which the appraisers value at..................	25,000

As to these the appraisers say: "*If* there is blocked out on this property about 1,500,000 tons of ore and a probability of 5,000,000 tons more, which would cost $0.70 per ton at the tide water, as per report of W. Price, M. E., then we appraise this property at $25,000 (Transcript, p. 32.)

Surely, this offhand estimate, based purely on hearsay and on a contingency, is not evidence on which the good faith of a previous sale of bonds can be impugned!

Next we find a silica prospect, appraised (Transcript, p. 33) at \$250, and on page 41 at 1,000

The above discrepancy well illustrates the speculative nature of the properties and the uncertainty of any value which may be attributed to them.

Next we find an iron mine in Nevada. As to this the appraisers say: "*In the absence of any other information concerning this property other than one mining report,* we are compelled to base our valuation upon a consideration of the agreed purchase price, and in connection therewith the probability of a cash sale within a reasonably short time." "*\$1,000 only has been paid on account* (Transcript, p. 33)."

The appraisers then estimate a clear title to this as having a cash value of.................. 25,000

The bankrupt company never had a clear title, however, only \$1,000 having been paid on the speculation. (Transcript, p. 33.) The original owners claimed a vendor's lien thereon in the sum of approximately \$100,000, proceedings for the foreclosure of which are now under way. (Agreed Statement of Facts, Transcript, p. 22.) This item must therefore be eliminated.

Next we find another mineral property valued on hearsay (Transcript, pp. 33, 34, 42) at 2,500

The next asset, though many thousands of dollars have been expended upon it, is reported as lapsed and worthless. (Transcript, pp. 34, 42.)

Finally we find certain naked options upon undeveloped coal and timber properties on one of the Queen Charlotte Islands, in British Columbia, valued at (Transcript, p. 34) 187,000

And subsequently (Transcript, p. 43) at $200,000.

Let us see what this item really represents. It is a seven-eighths ownership of the stock of a Canadian corporation called Western Coal & Iron Corporation, Ltd. This corporation was not the owner of the lands, but had a contract to acquire them by option under escrows in British Columbia. We quote from the agreed statement of facts (Transcript, p. 23):

"At the time of the sale of the securities in New York and of the bankruptcy in Seattle, there was due and payable upon these lands under pain of forfeiture of the escrows, $250,000.00, and there had been paid in the past approximately $150,000.00. The escrows call for annual payments of $50,000.00, with six per cent per annum interest payable semi-annually upon the whole deferred principal, and provide for absolute forfeiture of all past payments and cancellation of the option in case of twenty days' default in payment of principal or interest. * * * (And on p. 24.) The right of James A. Moore and Western Steel Corporation to the shares of stock in Western Coal & Iron Corporation, Ltd., above described were, however, at the time of the sale of the bonds in New York City, and at the time of the bankruptcy proceedings, in litigation, which is still pending and undetermined.

"At the time of the sale of the bonds in New York and also at the time of the bankruptcy in Seattle, the Graham Island tract was known to contain timber, and it was also supposed to contain a deposit of coal. *The latter, however, had never been explored, and its value was hypothetic.* The timber on the property, according to then available reports, was worth *a good share of the purchase price remaining unpaid.*"

The appraisers say: "*A great deal of expensive development work is required before it would be possible to realize on these coal properties.*" (Transcript, p. 34.)

Here is a speculative option in the most overboomed section of America, at the height, or rather *on the decline* of a period of speculation and vast inflation of values in British Columbia, and on this *only three-eighths of the purchase price has been paid,* the thread of *title being liable to be instantly cut off upon twenty days' default in payment of principal or interest.* (Transcript, p. 23.)

Is this the kind of property which the court will require one of our great banks, upon whose solvency the safety and prosperity of the country depends, to bid up and speculate upon, when all others in New York are afraid to risk any money on it, and the company that has pledged it is unable upon thirty days' notice to find a single bidder who offers more

than the Trust Company bid? Manifestly it is more of a liability than an asset.

The total of the highest appraised valuations of the property included in the mortgage (excepting the buildings at Irondale, which are not separately appraised), leaving out of account these Graham Island options and the Nevada property, upon which title had failed, but including the Quatsino Sound mining claims at a hearsay, contingent, and wholly speculative valuation of $25,000, is $52,000.

As against this, in estimating the value of the bonds secured by mortgage upon the properties, we must deduct the probable cost of foreclosure on these vast and scattered holdings, and a very heavy allowance for depreciation, and for such underlying liens as under the laws of the State of Washington take precedence of the mortgage debt. To this class belong *laborers' liens*, which, upon a plant of the character of that at Irondale, "which was then, and had ever since its construction, and for more than a year, been *operated intermittently* and *unsuccessfully*" (Transcript, p. 22), might well be expected to amount (as in fact they did) to between $25,000 and $50,000 (Transcript, p. 24).

Indeed a purchaser of the bonds could have no security that liens on such a plant would not amount

to $100,000 before foreclosure could be had. The law applicable to these liens, Remington & Ballinger's Code, Section 1149, is as follows:

"Every person performing labor for any person, company or corporation, in the operation of any railway, canal or transportation company, or any water, mining or manufacturing company, shall have a prior lien on the franchise, earnings, and on all the real and personal property of said person, company or corporation, which is used in the operating of its business, to the extent of the moneys due him from such person, company or corporation, operating said franchise or business, for labor performed within six months next preceding the filing of his claim therefor, as hereinafter provided; and no mortgage, deed of trust or conveyance shall defeat or take precedence over said lien." (L. '97. p. 55, Sec. 1.)

Quatsino Sound

The ~~Graham Island~~ claims, too, were subject to a lien of $2,500 (Transcript, pp. 24, 25).

Manifestly the purchase of these bonds at $25,000 was a risky investment. Their purchase at a higher price would have been still more risky. The appraisal furnishes little evidence that the mortgaged properties themselves were salable for more than $25,000, and no evidence that the bonds, as bonds, were worth more, having only a lien on the property subject to prior incumbrances and the expense and delay of foreclosure.

The bonds brought all that could have been expected under the circumstances.

At the sale of the bonds in New York there were other bidders, and the Trust Company was the highest and best bidder. (Agreed Statement of Facts, Transcript, p. 20). At the time of the sale the Western Steel Corporation had had thirty days' notice, and it may be presumed that among the other bidders were such persons as it had been able to interest in the bonds. In the nature of things, on all the evidence disclosed in this record, why should anyone pay more for them? The Graham Island and other outlying assets were wholly undeveloped and unproductive, and depended for their development and value on the steel plant at Irondale. (Transcript, p. 22.) The steel plant had never been operated successfully. We quote from the Agreed Statement of Facts (Transcript, pp. 22, 23):

"This was then an experimental industry on Puget Sound, no other steel plant being or having been in operation west of the Rocky Mountains, and the suitability of the plant's location, the adequacy and suitability of its construction and equipment, and the possibility of its profitable operation were then in doubt and dispute both in the commercial world generally and in New York, as well as in Seattle and in the State of Washington."

Furthermore *the order of the District Court shows that its decision upon the value of the property was rendered in part upon the several bids received by the trustees in bankruptcy for the various assets offered by them for sale.* (Transcript, p. 70.) The agreed statement of facts shows that bids other than those of the Metropolitan Trust Company were received only on a *trifling portion* of the property (Transcript, p. 27), and the Graham Island asset being appraised as the largest item among the Western Steel assets, we may, without departing from the record now before the court, state the fact that, though the sale conducted by the appellant trustees in Seattle was upon what they themselves concede to have been ample and sufficient notice, which was published a great number of times in numerous newspapers (Transcript, p. 27) at an expense probably of upwards of $1,000 (the expense of publication in two of the five newspapers in which the notice was published is shown to have been about $500), (Transcript, p. 61), *yet no bid but our own on behalf of Metropolitan Trust Company was received upon the Graham Island asset!*

How ridiculous is the position of the appellant trustees, who contend that the sale in New York was

insufficiently advertised and that the price there bid for the privilege of foreclosing upon these assets was inadequate, and yet are forced to admit that after they had given what they considered the most ample notice, they were unable to get one single cash bid for all or any substantial portion of the pledged assets! (Agreed Statement of Facts, Transcript, p. 27.)

2. Evidence of guilty knowledge necessary to a finding of fraud.

While the evidence seems to us conclusive that the price bid for the bonds was adequate and reasonable, still, even if we were to assume the evidence to show that it was unreasonable and inadequate, there would yet be lacking an essential element of fraud, namely, guilty knowledge and intent. A pledgee does not warrant that he will get the highest possible price. *The Western Steel Corporation, in pledging its bonds, refused to represent them as having any particular value whatever, leaving the estimated value of the collateral blank in the contract of pledge.* (Transcript, p. 50.) There is not a scrap of evidence that at the time of the sale the Trust Company had knowledge or notice, or could have discovered that the bonds ought to bring a greater

price, and, on the contrary, it appears by the agreed statement of facts, as already noted, that the bonds were of a so-called "wild cat" character, having never been listed as standard securities (Transcript, p. 20), and that, though descriptions of the mineral properties were available, their values were wholly uncertain (Transcript, p. 22), and the steel plant, which formed the nucleus of the property, was unsuccessful, and the possibility of its profitable operation was then in doubt and dispute, both in the commercial world generally and in New York, as well as in Seattle. Of the Graham Island option, the principal asset, according to the appraisal, it is admitted in the agreed statement of facts that it "had never been explored and its value was hypothetic." This statement of facts wholly negatives the element of knowledge that the price bid was inadequate, which is essential to the making out of a case of fraud in the foreclosure of the pledge.

3. Public sale in the New York market was, by the intent of the parties as disclosed in the contract of pledge, to be the final test of value.

On this point again we recur to the intention of the parties as shown in the contract. Having already discussed this under "I" and heretofore un-

der "H," we will not dwell upon it. There can be no fraud in the carrying out of a contract according to its terms and the original intention of the parties.

The pledgee was a bank. Its solvency was dependent upon its being able to liquidate its collateral promptly upon default in payment of pledgors' obligations. It was the intention of the parties that the pledgee should have the right to sell at once at public sale on the New York market, and realize whatever the collateral would bring, without being obliged to await a more favorable market, or speculate upon a possible excess of intrinsic value in each of its thousands of blocks of stocks and bonds, above the market value as fixed by the law of supply and demand. This is plain from the contract, and necessarily follows from a consideration of the circumstances under which the contract was made. Any other rule would be disastrous to business and finance, and in times of depression would mean the wholesale insolvency of banking institutions and the most widespread loss to depositors and the public.

A frequenter of the stock market daily hears it said of this or that stock or bond, that the company's assets give it an intrinsic value of double the market quotation, and this not infrequently is the case. It would upset all business to require pledgees of stocks

and bonds to investigate the intrinsic worth of pledged securities as indicated by the apparent value of corporation assets, and to hold the securities, unless the price bid for them equals their estimated theoretic value. Intrinsic value is dependent upon considerations of validity of title, secret incumbrances, continuity or faults in mineral lodes, prospects of continued successful operation, the personal equation, and innumerable other factors which it would be impossible for a pledgee to estimate or properly take into consideration.

There must be some final liquidation of the security, and test of its value. The parties agree that this shall be by public sale at the place of the pledge, and upon such sale, with notice to the pledgor to protect his interest, there is no more reason for overturning the sale on account of the collateral having brought a low price, than for overturning judicial sales upon foreclosure, at which it is the rule rather than the exception that the property is bid in reluctantly by the creditor at a price much less than its supposed intrinsic value. If refusal to bid in pledged property at its full estimated intrinsic value were held fraud, all foreclosure sales would be voidable, and by reason of uncertainty in the title conveyed, it would become practically impossible to

secure any bona fide bidder at sales of pledged collateral.

Referee and District Court Both Find Sale Was in Good Faith.

The Referee finds (Transcript, p. 9) that the foreclosure of the pledge in the bidding in of the bonds by the Trust Company was without any fraudulent intent upon its part. The District Court makes the same finding, intimating that in the pleadings and in the argument of the matter before the District Court it was conceded that "no fraud was practiced or existed." (Transcript, p. 68.)

This is the record on which the appellants now ask your Honors to find actual fraud on the part of Metropolitan Trust Company, voiding and nullifying the whole foreclosure procedure!

No Authorities Support Appellants' Contention That the Facts in This Case Evidence Legal Fraud.

Muhlenberg vs. Tacoma, 25 Wash. 36, is a case in which foreclosure of the pledge was had after the insolvency of the pledgor and when the pledgee knew that the pledgor and its receiver were helpless

to protect the collateral, and that the pledged warrants were absolutely valueless in the market. The president of the pledgee bank testified that the foreclosure sale was not held for the purpose of realizing on the security, but in order *to get title to the property.* (We take the italics from the court's opinion.) This is the ground on which the foreclosure sale was set aside, the court expressly saying:

"The object of the sale of a pledge contemplated by the law was to realize thereon in payment of the debt, and, if conducted fairly under the power given to the pledgee, it will not be set aside because the highest market price was not realized."

The court then distinguishes cases holding valid foreclosures under unfavorable circumstances at which inadequate prices were realized, saying:

"This case is far from supporting the proposition that the pledgee can sell when there is no market, and when he knows the thing offered for sale, *by reason of unforseen circumstances, is like so much waste paper, and has lost all its market value, and that such circumstances could not have been in contemplation of the parties when the pledge was made.* Under such conditions it was the duty of the pledgee to take action or at least he should have requested the pledgor to take the necessary steps to establish the validity of the pledge. (Meaning to establish the validity and value of the pledged securities which had been dishonored). *If the pledgor, on such request, should refuse to act, then a sale might be made,* for the refusal of the pledgor to act would be equivalent to an abandonment of the property.

In *Franklin National Bank vs. Newcombe*, 37 N. Y. Supp., 271, the court simply held that the creditor had a right to collect when his claim became due, and that the debtor could not compel him to wait because it was inconvenient to pay, and a bad time to realize on his assets. The stock and bonds in that case *had some market value*, and the pledgee knew he could realize something on them at the sale. The presumptions are all the other way in the case at bar. * * * The unfairness and inequitableness of this case consisted in attempting a sale when the pledgee knew * * that suits were pending to prove the pledged property of a value far in excess of the amount of the debt for which they were pledged. * * * There can be no pretense that there was any intention of realizing money by reason of this sale."

The *Muhlenberg* case is also based in part on Judge Ballinger's decision in *Morris vs. East Side Ry. Co.*, 95 Fed. 13, since reversed by this Court in *Morris & Whitehead vs. East Side Ry. Co.*, 104 Fed. 409, at 415.

In the *Morris & Whitehead* case, which appellants also rely on, this court after quoting the very language of Judge Ballinger's opinion which appellants print in their brief, says (p. 415):

"*We are unable to concur in these views of the court below.*"

It is thus seen that neither of these cases constitute any authority for appellants' claim.

Perkins vs. Applegate, 85 S. W., 723, the only other case cited by them on this point, is a Kentucky Court of Appeals case, "not to be officially reported." While there is some vague language referring to the old common law duties of pledgees, the case is decided on the ground that the pledgor's representative appeared at the time and place of sale and inquired of the auctioneer whether the sale was to occur, and was informed "that there would be no sale; that the stock had been withdrawn," and that the pretended sale was made secretly and not in public, the court saying:

> "This leaves Mr. Irwin making a sale with no one present, and acting as the agent of Mr. Perkins as trustee in selling, and as the agent of Perkins individually in buying. This was the same as if Perkins, as trustee, had sold to himself individually, with no one else present."

The court very properly holds that this was not a proper sale.

The three cases above digested are the only ones which appellants cite upon this point.

The authorities unanimously hold that such procedure as the Trust Company pursued in this case is entirely fair, and furnishes no evidence of fraud, and that it effectually forecloses the pledge.

Morris & Whitehead vs. East Side Ry., 104 Fed. 409, at 415,

Fidelity Insurance Co. vs. Roanoke Iron Co., 81 Fed. 439,

Farmers' National Bank of Annapolis vs. Venner, (Mass.) 78 N. E. 540,

Farmers' Loan & Trust Co. vs. Toledo & H. R. Co., 54 Fed. 759,

Wheelwright vs. St. Louis M. O. & O. C. T. Co., 56 Fed. 164.

III.

Appellants claim that the public notice was unreasonably short and the sale therefore invalid, because not a public sale.

We have very little comment to make on the third point on which appellants attack the order and findings of the District Court. The only evidence in the case shows that the notice given was such as is usual and customary in the sale of similar securities.

"But," the trustees exclaim, "these were unlisted and unknown securities."

They were in fact unlisted, but they were not unknown.

The trouble with them was that they were known, but not favorably known.

There is not a line of evidence that the fullest information regarding the properties covered by the mortgage securing the bonds was not readily available in New York, or that the bonds and the properties secured thereby were not as well known in New York as in Seattle, or anywhere else.

On the contrary, it affirmatively appears that the Western Steel assets and prospects were a subject of public interest and comment in the commercial world of New York, and that they were discredited by the speculative and experimental character of the undertaking (Transcript, p. 23). The most that can be said from the record and agreed statement of fact as to lack of information regarding the properties is that the general public information regarding the value of the bonds and the value of the properties securing the same was not "definite," and the same is true of any "wildcat" mining stock, representing properties like those of Western Steel Corporation, which consisted principally of *undeveloped mineral prospects.* That such stocks and bonds are not pledgable or when pledged cannot be sold at public sale like any other stocks or bonds, is a proposition wholly novel, and not supported, so far as we know, by a single adjudicated case.

The Trust Company had not furnished the collateral: It had taken what the pledgor offered, and if this was unpopular or of little value because of speculative character of the assets securing it, the pledgee was not responsible therefor. The bonds were known and had some market value in New York: nobody denies that. The Western Steel Corporation pledged them for the express purpose of their being sold at public sale "at any brokers' board," in case of default in payment of the note (Transcript, p. 52).

The trustees, standing in the shoes of the bankrupt, do not show any exceptional situation requiring delay in the sale of the bonds, or any change for the worse, rendering them unsalable or less salable, between the time they were pledged and the time they were sold.

Mr. Ives, in his testimony (Transcript, p. 47) says:

"For many years a great majority of the public auction sales of stocks and bonds, such as the said bonds of the Western Steel Corporation, which are not dealt in on New York Stock Exchange, nor sold on the curb, have been conducted by said Adrian H. Muller & Son as auctioneers."

And (p. 49) "The sale that was had of the said bonds was had in the same way in which public auction sales of such bonds are customarily and regularly had." Mr. McCormack testifies, (p. 56),

"In recent years we have conducted the great majority of the public auction sales of stocks and bonds in the city of New York. Every Wednesday, at 12:30 o'clock, we conduct such a public auction sale of stocks and bonds at the aforesaid Exchange Sales Rooms. Our custom is, preliminary to the sale, to send to practically all the important banking and financial corporations, firms and individuals in the financial district of New York City a list of the securities to be sold, and to advertise that list in the "New York Evening Post" of the day before the sale and in the "New York Times" and the "Wall Street Journal" of the day of the sale. These papers are selected because they are considered to be the best media for reaching those who would be likely to bid. * * * (p. 57). Upon the list for the sale on August 30, 1911, so sent to banking and financial corporations, firms and individuals and so advertised in the "New York Evening Post" on Tuesday, August 29th, and in the "New York Times" and "Wall Street Journal" on Wednesday, August 30th, were the bonds hereinbefore referred to. They formed one of twenty-four lots of different securities advertised for sale and sold on the said 30th day of August, 1911. * * * (p. 58). The methods pursued in connection with the aforesaid advertisement and sale of the bonds hereinbefore referred to were those which are customary. They were in all respects regular and the same as those pursued by us in connection with thousands of other lots of securities."

This testimony stands uncontradicted. There was no evidence offered of any different custom or usage. The trustees did not offer to show that longer advertising would have been more advantageous, and in the absence of testimony, it must

be presumed that the usual advertising is that which is found most advantageous and effective.

What Do the Trustees Show?

Now, if the trustees had really believed that this sale was insufficiently advertised, what would they have done? Of course, they would have produced evidence to show that the advertising given was less than is usual and customary, and that upon proper notice and advertising better bids could probably have been obtained. Is any such showing made here? Not by so much as a word of testimony. On the evidence there can be but one finding, and that is that the sale was conducted in every respect in accordance with custom and usage in the sale of unlisted stocks and bonds in the City of New York. Under the testimony in this case there is no issue on that point. It is not open to debate, and we wonder that, in the face of a record so conclusive able counsel for the trustees should continue to urge this objection.

The sale, as we have seen, was made on August 30, 1911. No objection was made and no steps were ever taken, and no proceedings brought by Western Steel Corporation, James A. Moore, or any other person, to attack or set aside the sale. The

question of the validity of the sale was raised for the first time in the bankruptcy proceedings commenced two months after the sale, and then only by way of objection to the Metropolitan Trust Company's claim, and not by any affirmative claim to the bonds or offer to redeem them.

We readily concede that the mere making of a sale in a public place is not conclusive, if through lack of notice, lack of attendance, unreasonable hour of sale, or other circumstances, there is no real publicity; but we think counsel for the trustees are in error in treating notice by public advertisement of any particular sale as the supreme test of publicity. Our opponents confuse the necessary requirements in the case of a sale in a small town, where there are no regular financial sales and no established market, and where particular notice is necessary in order to assemble even a half dozen possible bidders, with sales of securities in a great financial center where tens of thousands of men and institutions stand always ready to pick up all sorts of securities, if offered at a price which they believe to be advantageous, and where millions of dollars worth of stocks and bonds are daily and hourly sold on exchanges and on the curb, without any notice whatever, bringing always the market price, that

is to say, whatever the common judgment of the community estimates such securities to be worth.

This may be far more or far less than their intrinsic value. It is nevertheless their market price, and is all that a pledgee can be asked to secure. He is not bound to attempt to create a market by advertising and booming the securities. He is not bound to await a more favorable market or an increase in speculation in coal lands or iron deposits. He is not bound to await the determination of tariff schedules which may effect the marketability and value of a steel plant on the Pacific Coast. By the terms of the pledge the pledgee is authorized to do just what the pledgee did in this case, to offer the pledged securities in the financial market of New York and sell them for what they will bring, letting the purchaser assume all future risk as to their value, and take all chances as to whether their intrinsic worth is greater or less than the estimate which the financiers of New York put upon it, and all uncertainties as to future fluctuation. This is a contract right which the pledgee required, and the pledgor gave it him in consideration of a loan of $600,000 of the pledgee's money, advanced on the faith of the agreement. It must be given full force and effect.

Our adversaries cite on this point *Tennant vs. Union Central Insurance Co.,* 112 S. W. 754, in which there was a pretended sale and purchase of the pledged property by the treasurer of the company *in the company's office in Cincinnati, upon no public notice whatever.* Such cases as well illustrate the kind of sale that is bad in law, as the record in this illustrates the kind of sale that has always been held valid.

The same may be said of *Foot vs. Utah Bank,* 54 Pac. 104, where stock was sold at the front door of the bank, without notice or advertisement of any kind, and without public attendance, and wantonly sacrificed. We have no dispute with such a decision.

Laclede National Bank vs. Richardson, 56 S. W. 1117, also cited by appellants, hinges on defective notice and on the fact that at the time of the sale the weather was so inclement that bidders could not attend, and that the sale was not held in accordance with the advertisement of sale, being held inside the courthouse when advertised to occur at the courthouse door.

Possibly appellants may contend that by reason of the mortgaged properties being widely scattered,

the notice should have been longer, in order to permit their examination. The suggestion is absurd, however, because no mere bidder, having no certainty of acquiring the property, could afford to go to the expense of such examination. A large part of the securities dealt in by New York financial institutions are based on distant properties, and the delay proposed would paralyze business. These properties, too, are practically inaccessible. *Even the appraisers in bankruptcy found it impossible to visit them.* (Transcript, p. 36.) The bonds and their interest were payable in New York, (Transcript, p. 59) and the company and its properties were known in New York and the subject of discussion and dispute there. (Transcript, p. 23). No doubt more reliable information regarding the value back of the bonds was obtainable in ten minutes on Wall Street than in months of travel among these wild and scattered properties.

IV.

Our Opponents' Claim That the Sale Was Bad Because of Inadequacy of Price.

Appellants' argument is that the bank was bound to "get the highest cash value out of the col-

laterals," and that if the bonds were sold for less than their "highest value," the sale is bad.

We have already commented on the evidence which, as we think, shows that the price bid for the bonds was equal to their fair cash value, and which certainly justifies the finding of the District Court that no "such inadequacy of price is shown as would shock the conscience." (Transcript, p. 68, pp. 28 to 37, *supra.*)

Upon the question of law as to whether, in the absence of fraud, inadequacy of price will invalidate a properly conducted public sale of pledged collaterals, we desire to comment but briefly, as the rule is well settled by an overwhelming weight of modern authority, including decisions of the Circuit Court of Appeals for this Circuit. Any other rule would, as we have heretofore pointed out, unsettle business and render it impracticable for banking institutions to loan upon pledged collateral.

The following authorities sustain the rule that inadequacy of price is not a ground for setting aside a public sale, made in accordance with the contract of pledge:

In re Mertens (C. C. A., 2d Circuit), 144 Fed. 818, 822.

Farmers' Loan & Trust Co. vs. Toledo (C. C. A., 6th Circuit), 54 Fed. 759.

Wheelwright vs. St. Louis N. O. & O. C. T. Co., 56 Fed. 164.

Morris vs. East Side Ry. Co. (C. C. A., 9th Circuit), 104 Fed. 409.

Farmers' National Bank of Annapolis vs. Venner, 78 N. E. 540.

Fidelity Insurance Co. vs. Roanoke Iron Co., 81 Fed. 439.

Chouteau vs. Allen, 70 Mo. 290.

White, Receiver, vs. City of Rahway, 16 Fed. 833.

Jones on Pledges and Collateral Securities (2d Ed.), Sections 735, 727.

Franklin National Bank vs. Newcombe, 37 N. Y. Sup. 271, affirmed in the New York Court of Appeals, 51 N. E. 1090.

In *In re Mertens* (C. C. A., 2d Circuit), 144 Fed. 818, Judge Wallace, delivering the opinion of the court, says (p. 821):

"* * * by the stipulation of such a pledge as this was, the pledgor, *in effect* * * * *releases the pledgee from all the legal obligations which would ordinarily rest upon him in disposing of the property to satisfy his demand.* The authorities sanction such contracts. In *Baker vs. Drake*, 66 N. Y. 518, 23 Am. Rep. 80, it was decided that the parties to a transaction, which creates the relation of pledgee and pledgor between them, may provide by contract for any manner of disposing of the pledge to satisfy any claim upon it, which is not in

contravention of a statute, against public policy, or fraudulent. In *Toplitz vs. Bauer*, 161 N. Y. 332, 55 N. E. 1059, the court said: 'In recent times the rights of the parties to enter into a contract providing for a sale or disposition without notice have been recognized, and the disability of the pledgee to become a purchaser, it is said, may be removed by express stipulation of the parties.'"

The court then quotes and approves the language used in the *Roanoke Iron Co.* case, *supra,* and continues (p. 822):

"It may happen that a pledgee will be unable to obtain from others the sum which he believes he may be able to realize from the property by purchasing it himself, and disposing of it when a favorable opportunity offers. * * *"

Farmers' Loan & Trust Co. vs. Toledo (C. C. A., 6th Circuit), 54 Fed. 759, is precisely on all fours with the case at bar. It appears that $210,000 par value of first mortgage bonds of the Railroad Company were pledged as collateral security for a loan to the Railroad Company. The court says:

"The railroad company failed to make payment, and on the day designated, and at the place and time indicated in said notice, said bonds were sold at public auction, the sale having been also advertised in one or more of the daily newspapers of New York city, and were purchased by said bank at and for the sum of $20,000, which amount it credited on the railroad company's note."

Judge Jackson, delivering the opinion of the court (in which Taft and Hammond, J. J., concur), says:

"The securities having been regularly issued and hypothecated as collateral for a debt the company was authorized to contract, and thereafter lawfully sold under the terms of the pledge, upon proper notice, even the maker of the paper could not impeach the purchaser's title thereto, and the right to recover the amount thereof, *without setting up and establishing fraud or breach of trust causing injury.* * * * We think the court below was in error in not allowing the decree of foreclosure to go for the full amount of 210 bonds and unpaid coupons thereto attached."

In *Wheelwright vs. St. Louis N. O. & O. C. T. Co.*, 56 Fed. 164, it is said:

"*As to the foreclosure of the pledge, it seems to have been foreclosed in a manner strictly legal. The fact that at the sale under the foreclosure the bonds brought but little, there being no fraud shown, cannot impeach complainant's title.*"

In *Morris vs. East Side Ry. Co.* (C. C. A., 9th Circuit), 104 Fed. 409, this court considers a sale of railroad bonds on foreclosure of pledge at a price which the District Court held to be grossly and unconscionably inadequate, in view of the evidence of the earning capacity of the railroad. This court holds that there is no evidence of fraud, and that

the pledgor, at the sale, acquired a clear title to the bonds.

In *Jones on Pledges and Collateral Securities*, (2d Ed.), the general rule is stated as follows (Sec. 735):

"As regards the price obtained at a sale made under a power to sell without notice, the mere fact that the price obtained is less than the market price at the time does not alone make the pledgee liable for the difference. * * * A pledgee authorized to sell stocks and bonds pledged as collateral security at any brokers' board, or at public or private sale without notice, *may sell after the maturity of the debt secured, without waiting for a favorable condition of the market.*"

See also Sec. 727, as follows:

"When a creditor has given proper notice of the sale of the collateral security, the debtor has no alternative but to redeem the security by paying the debt for which it was pledged, or to allow it to be sold. He cannot resist the creditor's right to have the stock sold, on the ground that the sale could then be made only at a great sacrifice."

In *Chouteau vs. Allen*, 70 Mo. 290, it appears (p. 305) that 125 $1,000 first mortgage bonds of the C. & F. Ry. Co., secured by trust deed of 400,000 acres of land in Missouri, were pledged to secure a debt of the company, and the debt not being paid at maturity, the bonds were sold at public auction

in New York "at the usual place for such sales" for $7.00 per bond, or 7/10 of one per cent. of their par value. The bonds were bid in at this price by the pledgees themselves, and it does not appear that there were any other bidders. The court holds that the sale was valid and the pledgees acquired a clear title to the bonds.

White, Receiver, vs. City of Rahway (Circuit Court N. J.), 16 Fed. 833, is a suit in which a credit was claimed by defendant on account of certain bonds which had been pledged as collateral security and sold at a price which defendant alleged was much less than their market value. The bonds, of the par value of $50,000, had been pledged as security for an indebtedness of the same amount, and subsequently sold by the pledgee for some $11,000, leaving a balance of $40,000 remaining due on the original debt. The court says (p. 834):

"* * * It was insisted by the counsel for the city * * * that the bonds had been sold by the plaintiff *at much less than their market value;* and that the court should allow the defendant corporation the opportunity of *showing the true value of the said collaterals* in order to have the proper credit indorsed on the execution. * * * The plaintiff, on coming into the possession of the assets of the bank, found these collaterals, and, in pursuance of the authority vested in the bank when the

loan was made, handed them to *the well-known stock auctioneers, A. H. Muller & Son*, No. 7 Pine Street, New York, for public sale. They were regularly advertised to be sold *at the exchange sales-room, 111 Broadway, for Wednesday, January 11, 1882, at 12:30 o'clock P. M.* * * * that there were several bids for them, by which the price was run up somewhat, and they were struck down to a Mr. Bonner at 23½ per cent. * * * (p. 836). *The question is not whether a price was realized as great as might have been obtained under some other circumstances, but whether the plaintiff was free from all collusion, and acted within the limits of the authority conferred upon the bank, when the bonds were pledged, in regard to the mode of sale or default in the payment of the note.*"

Farmers' National Bank of Annapolis vs. Venner, 78 N. E. 540, was an action to recover the balance due on a promissory note after the sale and application of the collateral. Judgment was entered for the plaintiff in the sum of approximately $25,000, and it appeared that the collateral had been $26,000 par value of bonds. From the amount remaining due on the note, it appears that the collateral must have been sold for something under five cents on the dollar, and there was testimony tending to show that other bonds of the same issue were sold for a very much higher price both before and after the sale in question. In other words, *it appears to have been proved that the bonds were*

sacrificed for very much less than their actual market value. The court says:

"The fact that the bonds were sold for very much less than bonds of the same issue had been sold for previously and were sold for subsequently, and the further fact, if such was the fact, that Mr. Quinlan, who bid off the bonds for the plaintiff bank, was the only bidder, do not invalidate the sale. There is nothing to show that other bidders were not present, and *mere inadequacy of price is not of itself suffcient ground for setting aside a forclosure sale.*"

In *Fidelity Insurance Co. vs. Roanoke Iron Co.*, 81 Fed. 439, it appears that $12,000 par value of bonds were pledged to secure a debt of $5,000. Upon foreclosure, at public sale, they were bid in by the pledgee at a price which is not shown in the official report of the case. We have had the original records looked up by the clerk of the court, however, and ascertain that this $12,000 of bonds was bid in by the pledgee for $100, *or less than one cent on the dollar.* The court finds that the bonds were, as in the case at bar, "of uncertain value," though representing, as in this case, a lien upon a large manufacturing plant. Upon the question of the pledgee's title to the bonds, the court says:

"It would be imposing great hardship and injustice upon the pledgee, under the circumstances in this case, to say that while acting under the au-

thority given him by the pledgor, and in good faith, he shall be required to stand by and see the only security he has for the payment of his debt perhaps sacrificed, and he not permitted to protect his interests in the only way he can, by becoming a purchaser himself. The exception will be sustained, and, in the decree to be entered, Gwinner will be recognized as the owner of the bonds."

This language has been quoted and approved by the Circuit Court of Appeals, for the 2d Circuit, in *In re Mertens,* 144 Fed. 818.

Franklin National Bank vs. Newcombe, 37 N. Y. Sup. 271, affirmed in the New York Court of Appeals, 51 N. E. 1090, was an action to recover the balance due upon a promissory note for $20,000, to secure which certain stock and bonds had been pledged as collateral. The note fell due August 15, 1893, and was not paid. On the 30th day of August, 1893, the plaintiff sold the collateral at auction. As stated by the court in its opinion:

"The securities brought very low prices, and were bought in by the plaintiff. * * * Defendants alleged, as an answer to the plaintiff's claim, that the plaintiff had made the sale above mentioned, wholly disregarding its duty in that behalf, and reckless of the rights of the defendants, * * * and that said stock and bonds were bought by plaintiff (except one bond) with scarcely any opposing bidding, at a price far below their actual value. * * * It was argued that this evidence tended to show an intent to injure the defendants upon the part of

plaintiff in making the sale. * * * *The sole evidence offered was that the securities brought very low prices, and that the plaintiffs bought them in.* The plaintiffs were pursuing their legal rights, and the defendants, if they had chosen, could have protected the securities, as they knew of the sale. We know of no reason why a creditor may not enforce his legal rights, in a legal way, at any time."

The cases cited by appellants upon this point contain some general language relative to the old common law obligations of pledgees, but each of the cases in fact turns upon some defect in the foreclosure proceedings, such as failure to advertise the sale, or failure to hold it in a public place, in accordance with the contract of pledge.

Foot vs. Utah Bank, 54 Pac. 104, which appellants cite on this point, is, as we have already pointed out, a case in which there was no public sale, since the collateral was, *without notice or advertisement of any kind, and without public attendance*, sold at the front door of the pledgee bank and wantonly sacrificed.

Laclede National Bank vs. Richardson, 56 S. W. 1117, which we have heretofore commented upon under another point, is decided on somewhat similar grounds.

Other cases cited, such as *Montague vs. Dawes*, 14 Allen 373, concern the sale of real estate under

power of sale mortgages, in which considerations of intention of the parties and necessity for prompt liquidation do not require the same rules as in cases of foreclosure of pledged stocks and bonds.

Laches and Estoppel.

Even had there been grounds on which the Western Steel Corporation was entitled, at its election, to redeem the bonds after the sale in New York, such election could only have been made within a reasonable time after the sale, and in the case of securities issued by an unsuccessful company and secured by mortgage on an experimental plant, with the equity of the bonds liable at any time to be wholly consumed by the accumulation of other liens, such an election would have to be very promptly made.

It is shown by the record that the pledgor company made no objection to the sale of the bonds on August 30, 1911 (Transcript, p. 19), and that nothing was ever done by the pledgor or anyone else to set aside the sale, and that no question of the validity of the sale was ever raised until the objections were filed to the Trust Company's claim in the course of these bankruptcy proceedings. (Transcript, p. 21.) The trustees' objections to the Trust

Company's claim were filed April 15, 1912, nearly eight months after the bonds were sold in New York. (Transcript, p. 7.)

Under fundamental principles of equity neither the pledgor nor its trustees in bankruptcy had a right to speculate upon the outcome of the Steel Company's affairs, or to take the benefit of a right of redemption in case it proved profitable, without risking the $25,000 which the Trust Company bid for the bonds, in case that should prove to be more than their eventual value. Suppose that, as in a large majority of bankruptcies, the assets had been exhausted in paying labor and other prior claims and expenses of administration, would not the indorser on the note have been entitled still to insist upon credit for the $25,000 for which the bonds had been bid in? What the bankruptcy trustees really ask of this court is a ruling that pledgees bidding in collateral stocks and bonds take a title dependent on future developments as to the value of the securities, and that the pledgee may stand by and permit a sale of the securities without a protest, and months or years afterward make his election to attack or to affirm the sale.

Pledgee could not withdraw the bonds from auction sale, because of low price offered, without fraud on bidders Benjamin on Sales, (5th Ed.pp. 483 (foot

here would be no need for auction and
o bidders would attend.

IN CONCLUSION.

The fact that the Trust Company used between a quarter and a third of its $2,000,000 of bonds in a blanket bid on the properties of the bankrupt is of course no criterion of the *value of the properties.* It was an *exchange,* not a *purchase;* for the bonds, far from being worth par, are not shown to be worth anything. We might as well have bid $50,000 or $1,000,000, *in bonds,* and either bid would have amounted to the same thing—an exchange of paper for options and incumbered mineral prospects, thereby exhausting the lien of the mortgage and leaving the remainder of the bonds worthless except for a trifling dividend in the bankruptcy court.

The Trust Company, a heavy loser by its loan of over half a million dollars which is gone to help pay the creditors of Western Steel Corporation, is at least entitled to see its paper securities approved, its barren claim sustained against the bankrupt corporation, and its good faith in the sale of its burdensome and nearly worthless collateral vindicated by the judgment of this court.

We respectfully submit that the order of the District Court should be affirmed.

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